

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLANT**

77-7049

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ORIGINAL

----- X
GEORGE M. OSSERMAN, :

Plaintiff-Appellant, :

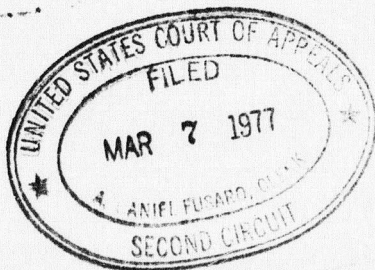
-against- :

BANK LEUMI TRUST COMPANY OF NEW YORK, :

Defendant-Respondent. :
----- X

On appeal from the United States
District Court for the Southern
District of New York

APPELLANT'S BRIEF



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STATEMENT OF THE ISSUES
PRESENTED FOR REVIEW

1. Did the defendant Bank as pledgee violate its fiduciary obligation to plaintiff and fail to exercise reasonable care to protect and preserve the value and validity of plaintiff's collateral deposited with it, when it turned over plaintiff's collateral for a loan that plaintiff had guaranteed, to plaintiff's former law partner Gloger, a co-guarantor who paid off the loan, in the face of (a) no right to effect such delivery contained in the agreement depositing the collateral (A-15), (b) knowledge (par. 15 of agreement between plaintiff and Gloger delivered to Bank, A-9) that any privilege of Gloger concerning plaintiff's collateral was strictly limited to "purchase" of same in a "foreclosure", should the Bank "elect to foreclose" on the collateral, (c) express written instruction from plaintiff's counsel two weeks prior to delivery by defendant of plaintiff's shares to Gloger, that when the loan was paid off defendant must return the collateral to plaintiff and not deliver it to anyone else (A-18), and (d) explicit knowledge of Gloger's intent to usurp ownership of plaintiff's shares, by virtue of receipt by defendant of a letter from Gloger, (before delivery of plaintiff's shares by defendant to Gloger) saying that by paying off the loan Gloger thereby became "sole owner" of plaintiff's shares (A-19).

2. Under the circumstances of this case, did defendant have the right, under the theory of subrogation, to absolve itself of any obligation or duty to plaintiff?

3. Does the complaint state a claim upon which relief can be granted?

4. Did the court below err in dismissing the complaint?

STATEMENT OF THE CASE

This is an action in which plaintiff in substance seeks an accounting of his property, consisting of limited and general partnership shares in Womig Associates (owner of a profitable bath and tennis club in Scarsdale), which had been deposited by plaintiff under a written agreement with the Bank as security for his guaranty of a loan to a corporation in which he was interested, which shares defendant delivered to the co-guarantor who paid off the loan (A-12).

Upon service of the complaint, and before answer, defendant moved to dismiss the complaint for failure to state a claim upon which relief may be granted (A-23). Plaintiff submitted his affidavit and certain exhibits in opposition to the motion (A-24 to A-44).

On January 10, 1977, Judge Inzer B. Wyatt made his decision granting the motion to dismiss the complaint (A-4 to A-7), holding that the Bank did not fail to exercise the reasonable degree of care required of it (A-7).

This appeal is from the judgment entered thereon, dismissing the complaint (A-3).

STATEMENT OF FACTS

Plaintiff and one Seymour Gloger ("Gloger") became law partners in 1951 in New York City. About 1960 they both acquired a 12 1/2% interest in Womig Associates, which operated a highly profitable club known as the Scarsdale Bath and Tennis Club. In 1966 they formed a corporation known as Heritable Security Corporation ("Heritable"), which operated an insurance agency in New York, and also organized a billing business for doctors in Boston, known as Medical Management Services Co. ("Medical Management"), a Massachusetts partnership. Plaintiff and Gloger were equal partners in the law partnership, Heritable and Medical Management, (A-24 to A-25; par. 5 of complaint, A-9).

In May, 1970, Heritable arranged for a loan from defendant, then known as First Israel Bank & Trust Co., and on May 28, 1970, plaintiff and Gloger agreed in writing (Exhibit A annexed to complaint, A-14 to A-17) to guaranty the loan, and both of them deposited with defendant as collateral security for their guarantees, their respective limited and general partnership shares in Womig (par. 4 of complaint, A-8 to A-9).

In order to obtain the loan to Heritable, plaintiff and Gloger each submitted a financial statement to defendant

in which each of them represented that his shares in Womig were worth \$102,128 and that Womig had a minimum value of \$750,000. Womig was in fact highly profitable. Its 1969 yearly report rendered by its certified accountant showed that the total profit for 10 prior operating seasons was \$519,986 and that the value of the club was approximately \$697,000. The profit increased sharply, since in 1967 it was \$62,099, in 1968, \$89,832, and in 1969, \$90,265.(A-25).

A Dun & Bradstreet report obtained by the defendant confirmed the value of the club to be more than one million dollars in June, 1970 (A-25 and A-30).

In fact plaintiff and Gloger had been receiving yearly distributions of \$6,000 to \$8,000 (A-25 to A-26).

In July, 1970, plaintiff and Gloger agreed to terminate all their partnerships, by a written dissolution agreement prepared by Gloger (A-26 and A-32 to A-42). In substance this agreement provided for assignment of the assets and liabilities of the law partnership and of Heritable to Gloger and those of Medical Management to plaintiff; that plaintiff would pay the balance of the bank loan; and that the accounts between Gloger and plaintiff would be adjusted to see who owed whom (par. 24 of dissolution agreement, A-40 to A-41), through accountants reports to be prepared by named

accountants, to wit, Irving Friedensohn ("Friedensohn") for the law partnership and Heritable, and Stone, Leavitt & Shuman ("Leavitt") for Medical Management (pars. 5, 10 and 17 of dissolution agreement, A-34, A-36 and A-39).

A copy of the dissolution agreement was delivered to the defendant (par. 6 of complaint, A-9), which, therefore, knew that Gloger had no right to acquire any of plaintiff's shares except under the conditions expressed in paragraph 15. That paragraph (A-9 and A-38) reads as follows:

"15. Osserman agrees that the outstanding loan of \$30,000 made by First Israel Bank and Trust Company of New York to Heritable was for the benefit of Osserman individually and Medical Management. Osserman has agreed to pay said loan, together with accrued interest and charges monthly as they fall due and fully, on or before December 30, 1970. For the purpose of collateralizing and guaranteeing payment of the said loan, Osserman agrees that in the event that he shall fail to meet the obligations herein set forth with respect to the aforesaid \$30,000 loan, and the bank shall elect to foreclose on the Womig interests assigned to it, Gloger shall have the right to purchase the whole of the Womig collateral, including Osserman's interest therein, by payment to the Bank of the amount sought on said foreclosure.

Upon such payment by Gloger, no other act or deed by Osserman shall be necessary to transfer full ownership of said Womig interest to Gloger."

The Bank knew, therefore, before the act complained of, that only if it should "elect to foreclose" on the Womig shares, then Gloger would have the right to "purchase" all the Womig collateral including plaintiff's shares, by paying the Bank "the amount sought on said foreclosure". It knew, therefore, that in no other way could Gloger acquire any right in or to plaintiff's shares.

In September, 1970, Leavitt rendered the accounting for Medical Management, which showed that Gloger owed plaintiff about \$50,000 on the deficit in his capital account (A-26 and A-43).

On March 18, 1971, the Bank wrote a letter to Heritable with copies to plaintiff and Gloger, asking for payment of the loan balance amounting to \$26,000 (A-44).

Plaintiff, knowing that he did not owe Gloger anything with respect to the law partnership and Heritable, and that Gloger owed him about \$50,000 on his capital account deficit in Medical Management, refused to pay the loan, taking the position that Gloger should pay off the loan out of the

money he owed plaintiff (A-27).

On March 26, 1971, counsel for plaintiff wrote to defendant stating that, should the loan be repaid, his collateral must be returned to plaintiff and to no one else. He said (Exhibit B annexed to complaint, A-18):

" *** no one other than George Osserman is the owner of such property (the collateral he deposited with defendant) and has any right, title and interest therein.

"In the event the loan should be repaid we herewith advise you that such security is to be returned to Mr. Osserman as the owner thereof and to no one else."

In the beginning of April, Gloger arranged with the Bank to pay off the loan balance, which he did on April 12, 1971. Gloger was determined to usurp ownership of plaintiff's shares and he made known to the Bank his intention to convert them. He wrote the Bank on April 12, 1971 (Exhibit C annexed to complaint, A-19), that by providing the funds necessary to satisfy plaintiff's obligation to pay off the loan he was thereby "purchasing" all of the collateral deposited and requested that the Bank release and transfer the collateral to him "as sole owner thereof".

By virtue of this letter the Bank was expressly

informed that Gloger claimed that by paying off the loan he became "sole owner" of the collateral, and the Bank knew that, if it released plaintiff's shares to Gloger, Gloger would claim he owned them.

While the Bank obtained from Gloger a second letter dated April 12, 1971, (Exhibit D annexed to complaint, A-20) in which Gloger stated that the collateral including plaintiff's was being released to him because of his payment of the loan, - this was merely a device to facilitate Gloger's purpose, and it in no way eliminated the knowledge that the Bank had obtained of Gloger's wrongful purpose to usurp ownership of plaintiff's Womig shares, which Gloger thereupon immediately did (par's. 10, 12 and 13 of complaint, A-10 to A-11), even though in a cover up attempt to protect the defendant its attorney wrote Gloger on April 16, 1971 (Exhibit E annexed to complaint, A-21 to A-22) that he had not "purchased" plaintiff's shares from defendant.

The complaint, therefore, alleges that, by delivering plaintiff's shares to Gloger thereby placing them under his dominion and control, the defendant directly aided and abetted Gloger in his assertion of ownership and afforded him the means to assume ownership by having them transferred to him on the records of Womig (par. 12 of complaint, A-10

to A-11).

Although plaintiff sued Gloger for the return of his shares in January, 1972, in the U.S. District Court for the District of Massachusetts, the action was stayed pending arbitration and it has dragged on since then, costing plaintiff thousands of dollars (par. 14 of complaint, A-11).

It further appears that when Gloger paid off the loan he was actually paying out of pocket only \$15,880, because he had taken plaintiff's yearly distribution share for the prior year amounting to \$6,500, and the Friedensohn accounting for the law partnership and Heritable showed that there was a \$3,619 credit due to plaintiff on his capital accounts with the law partnership and Heritable (A-27).

The inequity suffered by plaintiff at defendant's hands in wrongfully delivering plaintiff's Womig shares to Gloger is further highlighted by the facts that in 1975 the club was sold for \$1,100,000, plaintiff's share of which would have been \$109,633, if not for Gloger's wrongful usurpation of ownership of plaintiff's shares (par. 17 of complaint, A-12), and Gloger has claimed ownership of and retained the yearly distributions on plaintiff's shares that plaintiff would otherwise have received, totaling \$34,626 (par. 18 of complaint, A-12).

While Gloger had tried to make it appear that he was "purchasing" plaintiff's share in an effort in some way to come within paragraph 15 of the dissolution agreement, it is evident that the Bank had simply demanded payment of the loan, that the Bank did not "elect to foreclose", and that Gloger did not "purchase" plaintiff's shares, by paying off the loan, for "the amount sought on said foreclosure" (par. 15 of dissolution agreement, A-38).

Upon the basis of all of the foregoing, it shall be shown that the Bank violated its fiduciary duty as pledgee and violated its obligation to use reasonable care in the protection and preservation of plaintiff's Womig shares deposited with it as collateral; and that the defense asserted by defendant, under its claim that under the principle of subrogation it had the right to transfer plaintiff's collateral to Gloger, is utterly invalid.

POINT I

DEFENDANT AS PLEDGEE DID NOT USE REASONABLE CARE
IN CUSTODY AND PRESERVATION OF THE COLLATERAL
DEPOSITED BY PLAINTIFF

Both at common law and by statute a pledgee has the duty to use reasonable care in custody and preservation of the collateral entrusted to it.

The statutory duty to use reasonable care is expressed in Uniform Commercial Code § 9-207, which states:

"(1) A secured party must use reasonable care in the custody and preservation of collateral in his possession. **"

The same duty exists at common law. In Grace v. Sterling, Grace & Co. (A.D. 1st Dept.) 30 A.D. 2d 61, 289 N.Y.S. 2d 632, the Court stated, at pgs. 637-638, after referring to the statutory duty under § 9-207:

"Furthermore, at common law, and independent of the statutory provisions aforesaid, a pledgee, considered a bailee, is held bound to exercise ordinary care for the protection and preservation of the subject matter of the pledge. (See Restatement, Security, § 17, comment b; 53 N.Y. Jur., Secured Transactions, § 84, Willets v. Hatch, 132 N.Y. 41, 46, 30 N.E. 251, 153; Ouderkirk v. Central

Nat. Bank of Troy, 119 N.Y. 263, 23 N.E. 875; Cutting v. Marlor, 78 N.Y. 454; Hazard v. Wells, 2 Abb.N.Cas. 444; Fleming v. Northampton Nat. Bank, 62 How.Pr. 177).

"Where commercial paper or other securities are placed in the custody and control of the pledgee, it is clear that his responsibility is not limited solely to the physical preservation of the same. His responsibilities extend to the exercise of such care as a reasonably prudent pledgee would exercise under like circumstance to protect and preserve the validity and value of the securities. This is the rule at common law and also under the Uniform Commercial Coe. ***" (Emphasis added).

In performing this duty to protect the value of securities pledged, the pledgee must do nothing to impair that value. The pledgee must not do any affirmative act that would impair the value.

In Sterling Factors Corp. v. Freeman, 271 N.Y.S. 2d 343, 348, 50 Misc. 2d 715, aff'd. (A D. 2d Dept.) 27 A.D. 2d 956, 279 N.Y.S. 2d 577, the court pointed this out, stating:

"The holder of security *** is not at liberty to do any affirmative act which would impair the security ***"

See also: In Re Kiamie's Estate, 309 N.Y. 325, 330.

It can hardly be deemed to be reasonable care when the pledgee turns over the pledged property to one who has informed the pledgee that he intends to usurp ownership of it.

No rule of law or equity permits a pledgee to turn over the pledgor's collateral to a third person who says, "As soon as I get it, I own it." This is not reasonable care. This is not preservation of the collateral.

If this sort of thing were to be permitted, then we must abandon any sense of morality or equity.

Here the defendant was specifically instructed by plaintiff's counsel before it delivered plaintiff's Womig shares to Gloger not to turn over this collateral to anyone but plaintiff (A-18), and it was informed in writing by Gloger of his position that by paying off the bank loan he became the "owner" of plaintiff's shares (A-19).

The Bank could not ignore the instruction from plaintiff and could not ignore Gloger's expressed usurpation of ownership of plaintiff's shares when he got his hands on them. Thus, in Reed v. Central National Bank of Alva (C.A. 10th Cir.) 421 F. 2d 113, where the pledgor notified the

bank to exercise conversion rights in pledged debentures, but the bank simply ignored the letter sent by the pledgor, the court stated at p. 118:

"When the pledgor notified the bank of the call for redemption and requested conversion, the bank should either have converted or given the pledgor ample notice that it would not do so. The failure to act after notice from the pledgor was a breach of the bank's duty to use reasonable care."

Therefore, defendant's conduct in delivering plaintiff's Womig shares to Gloger was not only the grossest kind of negligence, but a deliberate perversion of its trust obligation.

While it is true that plaintiff had agreed to pay off the loan, this was an obligation under only one paragraph of an entire dissolution agreement between Osserman and Gloger, containing many other obligations under which they were dissolving three partnerships, to wit, their law practice, their insurance agency, Heritable, and their medical billing company in Boston, Medical Management. This agreement called for accountings, to determine in the final analysis which one owed the other and how much (A-40 to A-41). And an accounting rendered in the fall of 1970 by the accountants

named in the agreement for Medical Management had shown plaintiff that Gloger owed him a net of about \$50,000 on Gloger's capital account. Thus plaintiff had a right to set off his obligation to pay the balance of \$26,000 on the Bank loan against Gloger's obligation to him of almost twice as much on Gloger's capital account, and rightfully refused to ignore Gloger's obligation to him. Therefore, there is no equity or legality in considering the obligation of plaintiff, under paragraph 15 of the agreement, to pay the Bank loan, without giving effect to the other paragraphs of the agreement which mandated consideration of Gloger's \$50,000 obligation to plaintiff.

Furthermore, the complaint alleges that a copy of the dissolution agreement had been delivered to the Bank/ (par. 6, A-9) Therefore, the Bank is chargeable with knowledge of the fact that under paragraph 15 of the dissolution agreement, the only way that Gloger was permitted to obtain possession of plaintiff's shares was by "purchase", only if the Bank should "elect to foreclose" on the collateral, in which event Gloger could "purchase" plaintiff's shares for "the amount sought on said foreclosure" (par. 15, A-38).

To sum up, with knowledge of this provision restricting in this manner any privilege in Gloger to acquire plaintiff's

shares, and having been directed by plaintiff's counsel not to turn over plaintiff's shares to anyone but plaintiff (A-18), and having been informed by Gloger in writing of his position that by paying off the loan he deemed himself to be purchasing plaintiff's shares and to be the "sole owner" of them (A-19), - the Bank deliberately delivered plaintiff's shares to Gloger. This is a clear violation of defendant's obligations and duties to plaintiff.

In this connection it is relevant that, at the time the Womig shares were put up with the Bank as collateral, in May 1970, the Bank was informed, through financial statements filed by both plaintiff and Gloger, that plaintiff's shares had a value of \$102,128 (par. 4, A-25), and, through a Dun & Bradstreet report obtained by it, that the value of the bath and tennis club owned by Womig was more than a million dollars (par. 5, A-25).

Under the circumstances presented here the Bank did not perform its duty to protect and preserve the validity of plaintiff's ownership of the Womig shares and their value.

The duty of defendant to exercise reasonable care imposed an obligation "to guard against a reasonably foreseeable loss to the owner (of the personal property) ***"
(Grace v. Sterling, etc., supra at p. 638 of 289 N.Y.S. 2d).

It was "reasonably foreseeable" that, if defendant delivered plaintiff's shares to Gloger, plaintiff would suffer "loss" of ownership. In fact, this was glaringly obvious from the fact that before delivery of plaintiff's shares to Gloger, Gloger had informed defendant in writing that by paying off the loan he became "sole owner" (A-19).

The determination of the presence or absence of reasonable care must be made in the light of the circumstances of the particular case. Grace, supra, p. 639 of 289 N.Y.S. 2d.

The circumstances of this case, shown by the complaint and the evidentiary facts submitted by plaintiff, clearly establish absence of reasonable care.

The factors involved are stated, in Grace, supra, at pgs. 639-640, to be as follows:

"In determining the care to be exercised by a bailee, 'the nature and the value of the property, and the means of protection possessed by the bailee and the relation of the parties and other circumstances must be considered.'
(Cutting v. Marlor, 78 N.Y. 454, 458, supra; Willets v. Hatch, 132 N.Y. 41, 46, 30 N.E. 251, 253, supra). The pledgee is required to exercise that 'diligence which persons of common prudence usually bestow towards such property or upon their

own property at the time and place in question and under like circumstances; or, if the pledge be to bankers or others whose vocation implies skill or unusual facilities, such diligence as those commonly prudent of that class are wont to observe in such affairs.' (Schouler, Law of Bailments [3rd ed.], supra, § 204, p. 210)."

Let us consider these factors:

(a) "the nature and value of the property."

Plaintiff's shares, valued at \$102,128 (par. 4, A-25) in Womig Associates, which owned a highly profitable bath and tennis club (par. 3, A-25, and par. 18 of complaint, A-12), valued at over \$1,000,000 (par. 5, A-25).

(b) "the means of protection possessed by the pledgee."

Defendant could simply have told Gloger that, in view of his written assertion of ownership of plaintiff's shares (A-19), and in view of instruction from plaintiff's counsel (A-18) and the fact that there was no "foreclosure" and Gloger did not "purchase" the shares by paying off the loan (par. 15, A-38), Gloger had no right to plaintiff's shares and it refused to deliver them to him. Gloger then could only have brought an action demanding delivery of the shares to him, which would have been successfully defended by plaintiff on all the grounds raised in this brief.

(c) "the relation of the parties!"

Defendant had in its possession a copy of the dissolution agreement between plaintiff and Gloger, and knew that any privilege in Gloger to obtain plaintiff's collateral was strictly limited under paragraph 15 to a right of "purchase" for the "amount sought on foreclosure" of the collateral, should the Bank "elect to foreclose" (A-38).

(d) "other circumstances."

About two weeks before defendant delivered plaintiff's shares to Gloger it had received the letter from plaintiff's counsel (A-18) directing it not to turn over plaintiff's shares to anyone but plaintiff. The Bank knew that plaintiff's shares were worth at least \$102,000 as represented in the financial statements that plaintiff and Gloger had filed with it (par. 4, A-25). The Bank knew, by virtue of the Dun & Bradstreet report it had obtained, that the club owned by Womig was worth in excess of \$1,000,000 (par. 5, A-25). The Bank had been informed by letter from Gloger, before it turned over the shares to him, that he claimed to become the "sole owner" of plaintiff's shares, by paying off the loan (A-19).

Thus in turning over plaintiff's shares to Gloger, with knowledge that Gloger was claiming he thereby became the owner

of them, the Bank was guilty of negligence.

cf. Zayenda v. Spain & Spain Ltd. (A.D. 1st Dept.) 280 A.D. 752, 113 N.Y.S. 2d 115, rearg. den. 280 A.D. 861, 113 N.Y.S. 2d 920.

The Bank's actual knowledge of Gloger's fraudulent, illegal purpose to usurp ownership of plaintiff's shares eliminates any claim of ignorance and fixes its liability. cf. Gutekunst v. Continental Insurance Co. (C.A. 2d) 486 F. 2d 194.

A case that directly holds a bank liable for deliberately delivering pledged collateral to someone not the owner of it is the case of Signer v. First National Bank & Trust Co. of Covington, Kentucky (C.A. 6th Cir.) 455 F. 2d 382. The facts were as follows:

Salomine sold a boat harbor business to Arnold, who borrowed money from defendant bank to pay the purchase price, secured by a chattel mortgage and Salomine co-signed on the note given by Arnold. Arnold defaulted. Salomine in writing appointed his attorney, Signer, trustee to buy the Arnold note and the mortgage from the bank. Signer did this giving the bank a note for part of the price and pledging as security the Arnold note and mortgage. Signer sued Arnold in the

State Court for possession of the mortgaged property, upon his default. Arnold then, without notice to Signer, paid off the balance due on the Signer note, and the bank delivered the Arnold note and mortgage to Arnold. Arnold then promptly mortgaged the property to another bank in return for a loan, causing Signer to lose the collateral security. The action by Signer against Arnold was dismissed.

The Court held (p. 385) (a) that the bank "failed to exercise reasonable care when it deliberately delivered the Arnold Note and Mortgage to Arnold rather than to Signer, its owner." (Emphasis added), and (b) that Signer was entitled to recover full damages. This included (p. 386) interest from the date of wrongful conversion by the bank by delivery of the Arnold note and mortgage to Arnold and "such actual damages as he sustained as a result of the dismissal of the claim and delivery action ***"

POINT II

DEFENDANT'S CLAIM THAT GLOGER HAD AN ABSOLUTE
RIGHT OF SUBROGATION IS UNTENABLE

Defendant based its contention that the complaint should be dismissed upon its assertion that Gloger, as a co-guarantor paying off the loan, had an absolute right of subrogation, which the Bank was required by law to recognize.

There is ordinarily a right to request subrogation. But whether equity will permit subrogation in a particular case depends entirely upon the facts and circumstances of the case, for this right is not absolute but is dependent entirely upon the existence of equitable principles justifying subrogation.

In our case there was no equitable justification for subrogation, because the Bank had been notified not to turn over plaintiff's shares to anyone but plaintiff (A-18), the Bank knew that any right of Gloger was strictly limited by paragraph 15 of his dissolution agreement with plaintiff (A-9), the Bank knew that plaintiff's shares were worth in excess of \$100,000 (A-25), and the balance of the loan was only \$26,000, and the Bank knew before it delivered the shares to Gloger that he claimed that by paying off the loan he became the owner of plaintiff's shares (A-19).

In these circumstances the right of subrogation did not exist.

In Corpus Juris Secundum it is pointed out that subrogation is not a matter of strict right. In 83 C.J.S. par. 5, pgs.. 591-592 it is stated:

"The doctrine of subrogation is not a fixed and inflexible rule of law or equity and does not flow from any fixed rule of law; it is not a matter of strict right, but is, according to the authorities on the question, a matter of grace, the operation of which is governed and controlled by the principles of equity. It makes its appeal solely to the conscience of the court. ***"

It is further stated at pgs. 592-593:

"*** In other words, subrogation will not be enforced unless there is some equitable doctrine on which it can be predicated, and only when the applicant therefor has an equity to invoke and his cause is just and its enforcement is consonant with right and justice, and then only in a clear case. ***"

And it is specifically pointed out that subrogation will not be allowed "where it appears that plaintiff owes defendant an amount equal to, or greater than, the amount

claimed against defendant."

In this connection we again point out that had the Bank refused Gloger's request and had Gloger brought any action claiming subrogation, plaintiff could have established that Gloger had no right to subrogation because he owed plaintiff over \$50,000 on his capital account in Medical Management, which was approximately \$25,000 more than he had paid on the Bank loan.

It is also the rule that a person cannot seek subrogation who is acting in bad faith and is attempting to reap an illegal advantage, as is the situation here, since Gloger expressed his claim of ownership of plaintiff's shares before they were delivered to him. The applicable rule is stated as follows in 83 C.J.S. par. 6, pgs. 595-596:

"In order to warrant equitable relief of subrogation, the person seeking subrogation must act fairly and equitably and be free from fault. It will not be allowed where he has intermeddled with the rights of others or is guilty of fraud or culpable negligence, or where he would derive an advantage from, or establish his claim through, his own negligence or, in any way, would thereby reap advantage from his own wrongdoing, or from the wrongful act of one under whom he claims. Also, subrogation will not be allowed where to do so would

relieve a person from the consequences of his own wrongful or unlawful act." (Emphasis added)

It is obvious that in the face of Gloger's professed dishonest and fraudulent purpose, subrogation would only have accomplished injustice to plaintiff, and no court would have permitted it. It is further stated in 83 C.J.S. par. 6 p. 597:

"Subrogation will be granted only where an equitable result will be reached. It will not be allowed when to do so would be inequitable or where it would accomplish injustice. ***"

These equitable considerations are also expressed in the paragraphs dealing with subrogation in American Jurisprudence as follows:

73 Am. Jur. 2d par. 11, pgs. 605-6:

"*** It is not an absolute right, but one which depends on the equities and attending facts and circumstances of each case. ***"

Par. 12, p. 607:

"Relief by way of subrogation will not be granted where it would work injustice, or where innocent persons would

suffer, or where the result would be inimical to a sound public policy."

Par. 13, p. 607:

"The various maxims of equity, elsewhere considered, are brought into play when subrogation is sought. It frequently calls for an application of the maxim that 'no one shall be enriched by another's loss.' *** Another applicable maxim is that 'he who comes into equity must come with clean hands,' for equity will withhold subrogation from one who is guilty of a wrong in connection with the matter in controversy. ***"

Par. 15, p. 608:

"As in other cases of equitable relief, the court in administering subrogation will weigh and balance the equities of the parties, and have due regard to the legal and equitable rights of others. Subrogation will not be enforced to the prejudice of other rights of equal or higher rank, or to displace an intervening right or title, or to overthrow the equity of another person. Nor will it be enforced at the expense of a legal right ***"

And here too, the rules are expressed that subrogation is not an absolute right but "a matter of grace to be granted

or withheld as the equities of the case may demand. ***"
(par. 16, p. 609); that subrogation cannot be invoked to the
injury of an innocent third person, such as plaintiff (par. 17,
p. 609); and that it will be withheld from someone (Gloger)
guilty of wrongful or inequitable conduct respecting the
matter concerned, since it will not be enforced in favor of
a wrongdoer or one "who would reap an advantage in any way
from his own wrongful conduct or acts ***" (par. 18, pgs. 609-
610).

It is clear then that no right of subrogation existed
in this case and that the Bank has no defense to what it did
based on its resort to a claim of subrogation.

POINT III

DISMISSAL OF THE COMPLAINT WAS UNWARRANTED

The facts alleged in the complaint state a cause of action for violation by the pledgee defendant of its fiduciary duty to use reasonable care in the protection and preservation of plaintiff's Womig shares deposited with it as collateral.

The facts pleaded in the complaint must be "taken as admitted", Moore's Federal Practice, Vol. 2A, par. 12.08, p. 2267.

In Radovich v. National Football League, 352 U.S. 445, reh. den. 353 U.S. 931, the Court said that the test of sufficiency of a complaint is whether "the claim is wholly frivolous."

In view of the facts alleged, as analysed in Point I hereof, there is no ground for holding that plaintiff's claim is "wholly frivolous".

The facts set forth establish a clear negation of responsibility by defendant, - a clear violation of its duty to plaintiff.

A complaint is not to be dismissed for insufficiency

"unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim." Moore's Federal Practice, Vol. 2A, par. 12.08, p. 2274.

The complaint affirmatively establishes a state of facts warranting recovery upon the claim made.

Like a pledgee a bailee is required to exercise ordinary care and is guilty of negligence for failure to do so. It is a question of fact whether the loss is attributable to the bailee's negligence. Thus, in Kastner v. Insurance Co. of North America (A.D. 3d Dept.) 40 A.D. 2d 1, 337 N.Y.S. 2d 52, 55, the court said:

"The question of whether the loss here was attributable to Wendell's (bailee's) negligence was one of fact to be determined by the trial court. ***"

Even if the motion for dismissal were to be treated as a motion for summary judgment, because of submission by plaintiff of his affidavit in opposition (cf. Desrosiers v. American Cyanamide Co., C.A. 2d, 377 F. 2d 864), it is obvious that the facts submitted impel denial of such a motion. In the "Statement of Facts" and in Point I hereof, there are set forth the evidentiary facts and proof establish-

ing defendant's violation of its duty and ligation as pledgee. (See: Moore's Federal Practice, Vol. 2A, par. 12.09, pgs. 2311 and 2312, and notes).

In the case of Egelston v. State University College, etc. (C.A. 2d) 535 F. 2d 752, 754, the Court said:

"*** In our recent opinion in Heyman v. Commerce & Industry Ins. Co., 524 F. 2d 1317, 1320 (2d Cir. 1975), we emphasized that summary judgment must be used sparingly 'since its prophylactic function, when exercised, cuts off a party's right to present his case to the jury.' Dismissal of a complaint - before any discovery has taken place or an answer filed - is even more drastic. It is a device that must not be employed unless, taking as true the allegations pleaded, Cooper v. Pate, 378 U.S. 546, 84 S.Ct. 1733, 12 L.Ed.2d 1030 (1964) it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S.Ct. 1683, 1686, 40 L.Ed.2d 90 (1974), quoting Conley v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)."

POINT IV

THE RELIEF REQUESTED IN THE COMPLAINT IS
PROPER

The complaint states a good cause of action for redemption and an accounting.

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In/Am. Jur. 2d § 244, p. 99, it is stated:

"It has been held that an action in equity for redemption and an accounting will lie where stock pledged as collateral has been converted by the pledgee through a wrongful transfer (citing *Treadwell v. Clark*, 73 A.D. 473, 77 N.Y.S. 350)."

Also, by statute the secured party is liable for loss caused through its failure to use reasonable care in the custody and preservation of the collateral deposited with it. Uniform Commercial Code § 9-207 (3).

In the Signer case, supra (p.21 hereof) the Court held at p. 36 of 455 F. 2d, that damages recoverable included the expenses involved in the action brought by the pledgor against the third party to whom the pledged property was delivered by the pledgor. Here, too, plaintiff claims as damages the amounts expended by plaintiff in connection with the litigation with Gloger (par. 14, A-11 and subdivision 4, A-13).

POINT V

PLAINTIFF HAD AN ABSOLUTE RIGHT OF REDEMPTION
WHICH COULD NOT BE CUT OFF

Plaintiff had an absolute right of redemption of the pledged shares. This right could not be cut off without his consent, which of course, was never given. What the defendant did effectively deprived plaintiff of his ownership and cut off his right to redeem his pledged shares.

Uniform Commercial Code § 9-501 (3) and § 9-506.

Indiannapolis v. Karlen, 28 N.Y. 2d 30, 319 N.Y.S. 2d 831, 833, 834, 268 N.E. 2d 632.

Dopp v. Franklin National Bank (C.A. 2d) 461 F. 2d 873, 885.

POINT VI

AS PLEDGEE DEFENDANT HAD THE FIDUCIARY
RESPONSIBILITY OF A TRUSTEE

A pledgee is a trustee of collateral deposited with it by the pledgor.

In Re Kiamie's Estate, supra, 309 N.Y. 325, 330, 130 N.E. 2d 745, the Court said:

" *** Equity assigns to pledgor and pledgee a trust relationship with resulting obligations on the pledgee (citing cases). "

This case was cited with approval in Dopp.v. Franklin National Bank, supra, (C.A. 2d) 461 F.2d 873, 885.

As trustee it was the duty of defendant to protect the collateral for plaintiff.

"The very nature of the transaction gives rise to a trust relation between the pledgor and pledgee, with its consequent duties to protect the debt or obligation and the collateral." 49 Corpus Juris, Pledges, § 52, p. 921
(Emphasis added)

See also: Morris v. Windsor Trust Co., 213 N.Y. 27, 31, 106 N.E. 753, 754.

In Kono v. Roeth, 237 A.D. 252, 254, 260 N.Y.S. 662, 664, the Court said:

"Where the relation of pledgor and pledgee exists, the parties owe each other the mutual duty of preserving in good faith the pledge and to refrain from impairing its value.

Von Au v. Magenheimer, 126 A.D. 257, 110 N.Y.S. 629, aff'd. 196 N.Y. 510, 89 N.E. 1114. This relationship is one of trust (Gillet v. Bank of America, 160 N.Y. 549, 560, 55 N.E. 292, 295) ***" (Emphasis added).

See also: Wheeler v. Newbould, 16 N.Y. 392, 398

Toplitz v. Bauer, 161 N.Y. 325, 332, 55 N.E. 1059, 1061.

In the widely quoted case of First Deposit Co. v. Potter, 155 Misc. 106, 278 N.Y.S. 847, 854, the Court said:

"*** A pledgee is a trustee for the owner; he is not permitted to deal with trust property, excepting in that capacity and according to the terms of the agreement." (Emphasis added)

A pertinent and comprehensive statement of the obligation of a pledgee as trustee to control the pledged property with due regard to the interests of the pledgee is contained in Dibert v. D'Arcy, 248 Mo. 617, 647, 154 S.W. 1116, 1125

(incorporated with approval in Reconstruction Finance Corp.
v. Eastern T.C.R. Corp., 48 N.Y.S. 2d 920, 923-4, Misc.
) , as follows:

"Whenever a person comes into the possession and control of the property of another *** he becomes *** a trustee, and is charged by law as well as good morals to exercise such control with due regard to the interests of the beneficiary ** The possession and control is thought to give the trustee such opportunities for oppression and wrong in the management of the property as calls for the closest scrutiny of his acts, and out of this arises one of the most important branches of equity jurisdiction *** That this relation, with its consequent duties, exists between the pledgor and pledgee of collateral securities follows from the nature of the transaction. It is a trust for the protection of the debt, and the creditor holds the collateral as the trustee and agent of his debtor for that purpose. Richardson v. Mann, 30 La. Ann. 1060, and authorities cited."

As trustee the defendant owed plaintiff the duty of inflexible "undivided loyalty" and was required to measure up to "the punctilio of an honor the most sensitive".
Meinhardt v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545.

POINT VII

THE AGREEMENT BETWEEN PLAINTIFF AND DEFENDANT
DID NOT GIVE DEFENDANT ANY RIGHT TO ASSIGN HIS
COLLATERAL TO ANYONE OTHER THAN PLAINTIFF

Nothing in the guaranty agreement of May 29, 1970,
(A-14) gave defendant any right to assign the collateral to
anyone other than plaintiff.

As stated in Chris v. International Export & Import
Corp., 219 N.Y.S. 2d 314, 318-319, aff'd. 282 N.Y.S. 2d 662 #1:

"Curiously, neither instrument by which the securities
were pledged *** contains any language giving the Bank the
right to assign them to anyone else. These letters addressed
to the Bank, pledged them to the Bank and give only to the
Bank the right to retain them or to sell them in satisfaction
of the obligations created by the notes. The Bank did not
sell them for this purpose but assigned them to the plaintiff
as collateral for the notes without any express authorization
to do so." (Emphasis added by the Court).

In our case not only did the guaranty agreement give
defendant no right to assign plaintiff's shares to anyone
other than plaintiff, but, before defendant did deliver them
to Gloger, it was expressly told in writing by plaintiff's
counsel not to turn over the shares to anyone but plaintiff
(A-18).

Under the agreement the sole right of disposition of the collateral given to defendant was to sell it, upon default, on 10 days notice to plaintiff and Gloger (A-15).

Thus when the obligation was paid, it was defendant's duty to return plaintiff's Womig shares to plaintiff as the owner thereof.

69 Am. Jur. 2d § 306, p. 141, § 307, pgs. 142-143.

Uniform Commercial Code § 1-102 (3) and § 1-103.

53 N.Y. Jur. § 123, p. 428, § 237, pgs. 614-617.

CONCLUSION

The facts alleged by plaintiff establish a good and meritorious claim for failure of defendant to exercise reasonable care in protection and preservation of the validity and value of plaintiff's Womig shares deposited with defendant as collateral security under his written guaranty of defendant's loan to Heritable.

The complaint should not have been dismissed, and, therefore, the judgment appealed from should be reversed, and the motion to dismiss the complaint denied.

Respectfully submitted,

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2 Copies Received

Date March 7, 1977

Firm Parker, Chapin, Flannery & Klimpel

By [Signature]